Internal Revenue Service

memorandum

CC:TL-N-8685-90
Br4:MEHara

date: OCT 12 1990

to: District Counsel, Washington, D.C. MA:WAS

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [redacted] Suit Letter for Erroneous Refund

This is a preliminary response to your July 16, 1990 request for formal tax litigation advice in the above-entitled matter. As the issue that is the subject of your request is currently subject to a lively debate within CC:IT&A, we will be forwarding to your office a more comprehensive discussion as soon as a formal response is received from CC:IT&A.

ISSUE

Whether the tax benefit doctrine contained in I.R.C. § 58(h) applies under the rationale of *First Chicago Corporation v. Commissioner*, 842 F.2d 180 (7th Cir. 1988), *aff'g* 88 T.C. 663 (1987) to the alternative minimum tax under I.R.C. § 55 for the year [redacted] to the factual situation posed by the taxpayers.

CONCLUSION

It is our preliminary conclusion that the tax benefit doctrine as set forth in *First Chicago* does not apply to the alternative minimum tax imposed on non-corporate taxpayers where the credits involved are business credits other than the foreign tax credit. However, it is Service position that I.R.C. § 58(h) does apply to reduce the taxpayers' capital gains preference to they extent that they were not allowed to deduct charitable contributions in the current year because the preference reduced their adjusted gross income and thereby reduced their charitable contribution deduction.

DISCUSSION

BUSINESS CREDITS OTHER THAN THE FOREIGN TAX CREDIT

The conclusion that the tax benefit doctrine does not apply to the alternative minimum tax imposed on non-corporate taxpayers where the credits involved are business credits other than the foreign tax credit is based on the legislative history of I.R.C. § 55, which shows a clear intent to deny the very type of adjustment the taxpayers claim, *i.e.*, the reduction of current alternative minimum tax liability by business credits other than the foreign tax credit. As set forth in H.Rep. No. 95-1800, 95th Cong., 2d Sess. (1978), 1978-3 (vol. 1) C.B. 601:

> The conference agreement also retains those provisions of the Senate amendment which relate to certain charitable lead trusts and tax credits. Thus the foreign tax credit is to be allowed against the alternative minimum tax. However, individuals who pay the alternative minimum tax are not to obtain the benefit of nonrefundable credits other than the foreign tax credit to the extent of the individual's alternative minimum tax. Investment credit and jobs credit carryovers to future years, from a year in which the taxpayer is liable for some amount of alternative minimum tax, are not to be reduced to the extent the alternative minimum tax liability reduced the benefit of these credits.

In addition, taxpayers' reliance on *First Chicago* is misplaced. The *First Chicago* case dealt with the application of the tax benefit rules to the interaction of tax credits and the corporate minimum tax under I.R.C. § 56. This case examines the non-corporate alternative minimum tax under I.R.C. § 55, not a trivial distinction. Additionally, unlike the situation in *First Chicago*, there is no item for which the tax treatment giving rise to a preference will not result in the reduction of the taxpayers' tax under subtitle A of the Code for any taxable year. In the present case, the taxpayers have negative taxable income, however, if the taxpayers had not had the I.R.C. § 1202 deduction, they would have had sufficient regular taxable income to be able to use all of their tax credits. Even though the taxpayers' regular tax liability could be so reduced if they did not have the capital gain preference, however, the taxpayers are still subject to the alternative minimum tax. They therefore must compute and pay the alternative minimum tax to the extent that it exceeds their regular tax, in addition to paying their regular tax.

In further support of this position, note that in I.R.C. § 56(c)(3), Congress provided relief to individual taxpayers in cases where the individual taxpayers lost the benefit of tax credits applied against his regular tax because the taxpayer was liable for alternative minimum tax. See H.R. Rep. No. 250, 96th Cong., 1st Sess. 55 (1979). In these circumstances Congress provided for the carryback or carryover of these credits. Because Congress provided this relief, it apparently did not believe that I.R.C. § 58(h) applied in these circumstances. This is because if I.R.C. § 58(h) applied in these circumstances, taxpayers would have been able to reduce their preferences leading to a reduction of their alternative minimum tax liabilities in the current year. Thus, there would be no need to provide relief to these taxpayers.

CHARITABLE CONTRIBUTIONS

We note, however, that in the present case the taxpayers have charitable contributions carryovers and an I.R.C. § 1202(a) deduction. In regard to non-corporate taxpayers in this circumstance, it is Service position that I.R.C. § 58(h) does apply to reduce the taxpayers' capital gain preference to the extent they were not allowed to deduct charitable contributions in the current year because the preference reduce their adjusted gross income and thereby reduced their charitable contributions deduction.

For taxable year [redacted] I.R.C. § 1202(a) provides a deduction from gross income for a non-corporate taxpayer equal to 60 percent of the taxpayers' net capital gain. Under I.R.C. § 57(a)(9)(A), the I.R.C. § 1202(a) deduction is treated as a preference that is added back to adjusted gross income in computing the taxpayers' alternative minimum taxable income. I.R.C. § 170(b)(1) provides percentage limitations on the amount deductible for charitable contributions made for a taxable year. The limitations are stated as a percentage of a taxpayers' contribution base which is defined in I.R.C. § 170(b)(1)(F) as adjusted gross income, computed without regard to NOL carrybacks to the taxable year. Under I.R.C. § 170(d)(1), charitable contributions made by an individual in excess of the percentage limitations for a taxable year may be carried over to the five succeeding taxable years.

Because of the interaction of the above cited Code sections, CC:IT&A has taken the position that a taxpayer having a capital gains deduction and an amount of charitable contributions in excess of his deduction limitation derives no tax benefit within the meaning of I.R.C. § 56(h) for a certain portion of this capital gains preference. Consequently, the I.R.C. § 58(h) does apply to reduce the taxpayers' capital gain preference to the extent they were not allowed to deduct charitable contributions in the current year. This is because the preference reduce their adjusted gross income and thereby reduced their charitable contributions deduction.

Please contact Michael E. Hara at FTS 566-3305 if you have any questions or need further assistance in the meantime.

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